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THE *STARKER* CASES: DEFERMENT OPPORTUNITIES UNDER I.R.C. SECTION 1031

I. AN INTRODUCTION TO NONRECOGNITION TREATMENT UNDER I.R.C. SECTION 1031

Internal Revenue Code section 1031¹ was enacted as a mandatory exception² to I.R.C. section 1001(c),³ and was intended to defer recognition of gain or loss on an exchange of like-kind property.⁴ Ordinarily the fair market value of property received in a bargained-for exchange

1. I.R.C. § 1031 states the requisites necessary to qualify as a nontaxable exchange. The exchange must result from a transfer of business or investment property exchanged solely or primarily for property of a like-kind. All section references are to the Int. Rev. Code of 1954, Ch. 736, 68A Stat. 302 *as amended* by Act of Dec. 30, 1969, Pub. L. No. 91-172, § 212(c)(1), 83 Stat. 571, and the regulations promulgated thereunder, unless otherwise indicated.

Since I.R.C. § 1031 is the subject of this note's analysis all relevant sections appear below.

§ 1031. *Exchange of Property Held for Productive Use or Investment*

(a) *Nonrecognition of gain or loss from exchanges solely in kind.*—No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment.

(b) *Gain from exchanges not solely in kind.*—If an exchange would be within the provisions of subsection (a), of section 1035(a), of section 1036(a), or of section 1037(a), if it were not for the fact that the property received in exchange consists not only of property permitted by such provisions to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(c) *Loss from exchanges not solely in kind.*—If an exchange would be within the provisions of subsection (a), of section 1035(a), of section 1036(a), or of section 1037(a), if it were not for the fact that the property received in exchange consists not only of property permitted by such provisions to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

Id. I.R.C. § 1031(d) deals with the determination of adjusted bases in properties exchanged, while I.R.C. § 1031(e) discusses exchanges of livestock of different sexes not held to constitute like-kind property. Accordingly, they are not pertinent to this note's discussion of I.R.C. § 1031.

2. *United States v. Vardine*, 305 F.2d 60 (2d Cir. 1962).

3. I.R.C. § 1001(c). This section authorizes recognition of gains or losses resulting from sales or exchanges. Specifically, the section states that "[e]xcept as otherwise provided in this subtitle, on the sale or exchange of property the entire amount of the gain or loss, determined by section 1001, shall be recognized." I.R.C. § 1002 contained a similar provision dealing with recognition of gain but was repealed for the taxable years beginning after 1976.

4. See note 1 *supra* and accompanying text.

is considered the equivalent of cash for income tax purposes.⁵ The taxpayer receiving such property is generally required to report the gain realized on the transaction.⁶ Section 1031 was enacted to guard against the possible inequity which might result from the exchange⁷ if it were afforded taxable treatment under section 1001(c).⁸ Specifically, a taxpayer may technically realize a gain or loss although his net assets remain unchanged.⁹ Without the exception provided by section 1031, the taxpayer would be compelled to recognize a paper gain associated with property which, since merely exchanged, represents only a continuation of the initial investment.¹⁰ The effect of nonrecognition treatment is to provide a tax shelter in instances where the taxpayer defers recognition of gain.

Under the protective shelter of section 1031¹¹ many taxpayers have attempted to defer recognition of gain under the guise of a continuing investment.¹² The courts, aware of this stratagem, have been reluctant to defer recognition treatment in situations which fail to precisely fit the statutory language.¹³ Section 1031's status as an exception to the general rule precipitates its strict construction.¹⁴ Section 1031 is subject to

5. The fair market value often determines the adjusted basis of the property which, when subtracting the original basis therefrom, establishes the amount of recognized gain or loss.

6. I.R.C. § 1001(c). This section authorizes recognition of gains or losses resulting from sales or exchanges.

7. *Jordan Marsh Co. v. Commissioner*, 269 F.2d 453 (2d Cir. 1959) discusses the legislative history of Int. Rev. Code of 1939, ch. 736, § 112(b)(5), 68A Stat. 302 (now I.R.C. § 1031).

It is the purpose of Section 112(b)(5) to save the taxpayer from an immediate recognition of a gain, or to intermit the claim of a loss, in certain transactions where gain or loss may have accrued in a constitutional sense, but where in a popular and economic sense there has been a mere change in the form of ownership and the taxpayer has not really 'cashed in' on the theoretical gain, or closed out a losing venture.

Id. at 546. See also *Fairfield S.S. Corp. v. Commissioner*, 157 F.2d 321, 323 (2d Cir. 1946).

8. See note 3 *supra*.

9. See note 7 *supra* and accompanying text.

10. *Id.*

11. See note 1 *supra* and accompanying text.

12. See note 7 *supra* and accompanying text.

13. *Cf. Smith v. Commissioner*, 537 F.2d 972 (8th Cir. 1976) (the taxpayer attempted to avoid recognition treatment by structuring his transfer to meet the I.R.C. § 1031 requirements. Upon close scrutiny, the court revealed a sale disguised as an exchange and precluded nonrecognition treatment).

14. Treas. Reg. § 1.1002-1(b) (1960) *Strict Construction of Exceptions From General Rule*:

The exceptions from the general rule requiring the recognition of all gains and losses, like other exceptions from a rule of taxation of general and uniform application, are strictly construed and do not extend either beyond the words or the underlying assumptions and purposes of the exception. Nonrecognition is accorded by the Code only if the exchange is one which satisfies both (1) the specific description in the Code of an excepted exchange, and (2) the underlying purpose for which such exchange is excepted from the general rule.

the interpretation in Treasury Regulation section 1.1002-1(b).¹⁵ This regulation states that “[n]onrecognition is accorded by the Code only if the exchange is one which satisfies both (1) the specific description in the Code of an excepted exchange, and (2) the underlying purpose for which such exchange is excepted from the general rule.”¹⁶ This two tier analysis is typically applied to the facts of each case interpreting section 1031.

Analysis of cases interpreting section 1031 reveals several notable factors that courts consider in determining whether to delay recognition of gain.¹⁷ Among these factors are the following: (1) whether the substance of the transfer meets the express congressional purpose;¹⁸ (2) whether the nature of the transfer involves an exchange of like-kind property;¹⁹ and (3) whether the element of simultaneity has been satisfied.²⁰ While all of these factors remain significant, the predominant factor in recent opinions relates to the question whether the substance of the exchange meets the express congressional purpose of section 1031.²¹ *Bruce Starker v. United States*²² and *T.J. Starker v. United*

Id. Although I.R.C. § 1002 has been repealed and incorporated into I.R.C. § 1001(c), Treas. Reg. § 1.1002-1(b) remains in effect and interprets I.R.C. § 1001(c).

15. *Id.*

16. Treas. Reg. § 1.1002-1(b) (1960).

17. This paper, in discussing the exchange and like-kind property concepts, in addition to the legislative purpose of I.R.C. § 1031, relies primarily on the following case law from which the significance of these factors becomes apparent. *See* *Commissioner v. Brown*, 380 U.S. 563 (1965); *Commissioner v. Court Holding Co.*, 324 U.S. 331 (1945); *Gregory v. Helvering*, 293 U.S. 465 (1935); *Starker v. United States*, 602 F.2d 1341 (9th Cir. 1979); *Weisbart & Co. v. First Nat'l Bank of Dalhart*, 568 F.2d 391 (5th Cir. 1976); *Leslie Co. v. Commissioner*, 539 F.2d 943 (3d Cir. 1976); *Redwing Carriers, Inc. v. Tomlinson*, 399 F.2d 652 (5th Cir. 1968); *Carlton v. United States*, 385 F.2d 238 (5th Cir. 1963); *Coastal Terminals, Inc. v. United States*, 320 F.2d 333 (4th Cir. 1963); *United States v. Vardine*, 305 F.2d 60 (2d Cir. 1962); *Jordan Marsh Co. v. Commissioner*, 269 F.2d 453 (2d Cir. 1959); *Century Electric Co. v. Commissioner*, 192 F.2d 155 (8th Cir. 1951); *Fairfield S.S. Corp. v. Commissioner*, 157 F.2d 321 (2d Cir. 1946); *Trenton Cotton Oil Co. v. Commissioner*, 147 F.2d 33 (6th Cir. 1945); *Portland Oil Co. v. Commissioner*, 109 F.2d 479 (1st Cir. 1940); *Starker v. United States*, 432 F. Supp. 864 (D. Or. 1977); *Biggs v. Commissioner*, 69 T.C. 905 (1978); *124 Front Street, Inc.*, 65 T.C. 6(A) (1975); *Coupe v. Commissioner*, 52 T.C. 394 (1969); *Leo A. Woodbury*, 49 T.C. 180 (1967); *Rogers*, 44 T.C. 126 (1965); *J.H. Baird Publishing Co.*, 39 T.C. 608 (1962); *Mercantile Trust Co. of Balt. v. Commissioner*, 32 B.T.A. 82 (1935); *Starker v. United States*, 35 AFTR 2d 75-1550 (P-H), 75-1 U.S. Tax.Cas. (CCH) ¶ 8443 (D. Or. 1975); *Juhl Smith*, ¶ 75-153 T.C.M. (P-H) (1975). *See* note 196 *infra* and accompanying text for a list of cases interpreting I.R.S. § 1031 by other circuit courts of appeal as well as by the U.S. Tax Court.

18. *See* notes 53-77 *infra* and accompanying text.

19. *See* notes 85-97 *infra* and accompanying text.

20. *See* notes 103-13 *infra* and accompanying text.

21. *See* notes 53-84, 161-66 *infra* and accompanying text. *See* *Starker v. United States*, 602 F.2d 1341 (9th Cir. 1979); *Alderson v. Commissioner*, 317 F.2d 790 (9th Cir. 1963); *Starker v. United States*, 35 AFTR 2d 75-1550 (P-H), 75-1 U.S. Tax.Cas. (CCH) ¶ 8443 (D. Or. 1975).

*States*²³ evidence the courts' willingness to broadly construe the section 1031 exception²⁴ by affording nonrecognition treatment to transfers which fall within the provision's underlying purpose.²⁵ This represents a significant departure from the era of strict construction in which close adherence to the express or implied dictate of section 1031 was required.²⁶

This note analyzes the *Starker* cases'²⁷ interpretation of nonrecognition treatment under I.R.C. section 1031 and focuses on their reappraisal of the factors used to interpret section 1031. Although traditional factors are not discarded, *Starker I* and *Starker II* emphasize new priorities.²⁸ The *Starker* opinions suggest that strict interpretation of section 1031 is of diminished value when compared with the more inclusive treatment of transfers envisaged by the *Starker* cases. Their elevation of substance over form has, with respect to certain transactions, generated enthusiasm among practitioners seeking to maximize tax deferment opportunities.

II. *STARKER I* AND *STARKER II*: THE FACTS AND ISSUES

A. *Examining Starker I*

In *Starker I*,²⁹ taxpayers received nonrecognition treatment under section 1031 in transactions where they relinquished title and control of their property in exchange for a promise, from their corporate transferees, to convey like-kind property in the future.³⁰ The *Starkers* entered into two similar agreements, one with the Longview Fibre Company and the other with the Crown Zellerbach Corporation. In both transactions real estate exchange agreements were executed³¹ in which the *Starkers* agreed to convey particular realty to those companies in return

22. 35 AFTR 2d 75-1550 (P-H), 75-1 U.S.Tax.Cas. (CCH) ¶ 8443 (D. Or. 1975) [hereinafter referred to as *Starker I*].

23. 602 F.2d 1341 (9th Cir. 1979) [hereinafter referred to as *Starker II*].

24. I.R.C. § 1031.

25. See note 7 *supra* and accompanying text.

26. See note 14 *supra* and accompanying text.

27. Any plural references to the *Starker* cases refer both to *Starker I* and *Starker II*.

28. See notes 143-92 *infra* and accompanying text.

29. *Starker v. United States*, 35 AFTR 2d 75-1550 (P-H), 75-1 U.S.Tax.Cas. (CCH) ¶ 8443 (D. Or. 1975).

30. *Id.*

31. These agreements evidenced the taxpayers' intent to exchange realty, as well as the value of such realty.

for a credit in the amount of the value of the realty transferred.³² The Starkers did not control the cash used by the companies to purchase the like-kind properties selected by the Starkers in exchange for their land. In addition, the Starkers did not have the right under the contract to demand cash in lieu of property.³³ The contract did state, however, that both parties must agree in writing to the value of the properties conveyed³⁴ before the agreement could be credited accordingly. Nevertheless, the agreement stated that if a credit balance remained after a five year period, the companies would pay the Starkers in cash. Ultimately, both companies transferred parcels of realty to the Starkers reducing the exchange value credit to zero, so that realty, not cash, exchanged hands.

The Starkers' claim that nonrecognition treatment should be afforded under I.R.C. section 1031 was rejected by the Internal Revenue Service.³⁵ Accordingly, the question presented was whether a promise to convey property in the future in exchange for a present transfer of realty satisfied the like-kind property requirement prescribed by section 1031.³⁶ The Internal Revenue Service argued that a promise in exchange for realty did not satisfy the like-kind requirement. The Starkers contended, however, that the promise was merely an intermediate step resulting in an exchange of like-kind property. The court adopted the taxpayers' position and accorded section 1031 status to the transaction.³⁷

B. *Examining Starker II*

*Starker II*³⁸ presents factual patterns and legal issues similar to

32. *Starker v. United States*, 35 AFTR 2d 75-1550 (P-H), 75-1 U.S.Tax.Cas. (CCH) ¶ 8443 (D. Or. 1975).

33. *Id.* at 1551.

34. *Id.*

35. Although the *Starker I* opinion does not discuss the reasons why the I.R.S. opposed I.R.C. § 1031 treatment, presumably the I.R.S. found the like-kind property requirement lacking. In the opinion of the I.R.S., the Starkers' transfer of realty, in exchange for a promise to convey realty in the future, was changing the nature of the property from realty to personalty, precluding I.R.C. § 1031's application. Additionally, the I.R.S. claimed that I.R.C. § 1031's operation was precluded because of the possibility that the Starkers may have received cash in exchange for their realty, in noncompliance with the like-kind property requirement of I.R.C. § 1031(a).

36. *Starker v. United States*, 35 AFTR 2d 75-1550 (P-H), 75-1 U.S.Tax.Cas. (CCH) ¶ 8443 (D. Or. 1975).

37. *Starker v. United States*, 35 AFTR 2d 75-1550 (P-H), 75-1 U.S.Tax.Cas. (CCH) ¶ 8443 (D. Or. 1975). At 75-1551 the court states that the taxpayers "exchanged those properties solely for properties of like-kind to be held by them either for productive use in their trade or business or for investment within the meaning of Section 1031(a) of the Internal Revenue Code." *Id.*

38. *Starker v. United States*, 602 F.2d 1341 (9th Cir. 1979).

*Starker I.*³⁹ In 1967, T.J. Starker and the Crown Zellerbach Corporation entered into a land exchange agreement.⁴⁰ The agreement directed Starker to convey his timberland to Crown. As consideration, Crown agreed to acquire and deed⁴¹ other realty to Starker within five years or, in the alternative, to pay him the value of his timberland.⁴² Approximately two months later,⁴³ Starker conveyed his timberland to Crown. In recognition of Starker's performance Crown then entered into its records an exchange value credit of \$1,502,500.⁴⁴

At Starker's direction Crown subsequently conveyed parcels of realty over the next two year period, representing Crown's compliance with the exchange agreement.⁴⁵ Crown purchased the majority of these parcels from third parties and conveyed them directly to Starker.⁴⁶ In one instance, however, Crown secured a third party purchaser's right to a realty parcel and reassigned that right to Starker. As in *Starker I*, the exchange value credit was reduced to zero by virtue of the land transfers and no money exchanged hands.

Starker claimed nonrecognition treatment under section 1031 in his 1967 income tax return. Although he reported no gain on the transactions, his bases in the properties relinquished were less than the market value of the properties received.⁴⁷ Accordingly, the Internal Revenue Service claimed that section 1031 was inapplicable and assessed the appropriate deficiency.⁴⁸

On appeal the Ninth Circuit held that Starker's transfer of timberland in exchange for Crown's promise and subsequent performance constituted a like-kind exchange that was entitled to nonrecognition treatment under section 1031.⁴⁹ This determination rested on the conclusion that the substance of the exchange fit squarely within section 1031's express congressional purpose.⁵⁰ The court's willingness to ex-

39. 35 AFTR 2d 75-1550 (P-H), 75-1 U.S.Tax.Cas. (CCH) ¶ 8443 (D. Or. 1975). Both *Starker* cases involved members of the same family entering into exchange agreements with the Crown Zellerbach Corporation.

40. *Starker v. United States*, 602 F.2d 1341, 1342 (9th Cir. 1979). This agreement was entered into on April 1, 1967.

41. *Id.* at 1343.

42. *Id.*

43. This transfer occurred on May 31, 1967.

44. *Starker v. United States*, 602 F.2d 1341, 1343 (9th Cir. 1979).

45. *Id.* Crown transferred a total of twelve parcels of realty to Starker.

46. 602 F.2d 1341, 1343 (9th Cir. 1979).

47. *Id.* at 1343.

48. *Id.*

49. *Id.*

50. See note 7 *supra* and accompanying text.

amine the substance of the transaction in the context of the statute's expressed congressional purpose⁵¹ signalled the beginning of a new era of nonrecognition treatment under section 1031.⁵²

III. I.R.C. SECTION 1031: NONRECOGNITION TREATMENT PRIOR TO *STARKER I* AND *II*

A. *The Determinative Feature: Does the Substance of the Transaction Meet the Congressional Purpose?*

Since the application of section 1031 is mandatory,⁵³ it is necessary to critically examine the facts of a given exchange when determining whether a particular transaction falls within the ambit of that section.⁵⁴ In recent cases, the actual result has been determinative.⁵⁵ The courts have emphasized that an examination of the substance of a transaction,⁵⁶ as opposed to its form, is crucial in determining whether it complies with the statutory purpose.⁵⁷ The language of section 1031(a) mandates nonrecognition treatment for gains resulting from property "exchanged solely for property of a like kind."⁵⁸ As an exception to section 1001(c),⁵⁹ section 1031 is subject to the narrow interpretation enunciated in Treasury Regulation 1.1002-1(b).⁶⁰ This regulation confers nonrecognition treatment on transactions meeting the congressional purpose underlying section 1031,⁶¹ as well as those precisely fitting its statutory language.⁶²

Analysis of the legislative history of section 1031 reveals concern with recognizing an intermittent gain or loss for a continuing and unrealized investment.⁶³ Stressing fundamental fairness, Congress de-

51. *Starker v. United States*, 602 F.2d 1341 (9th Cir. 1979). See note 7 *supra* and accompanying text.

52. I.R.C. § 1031.

53. *United States v. Vardine*, 305 F.2d 60 (2d Cir. 1962).

54. I.R.C. § 1031; Treas. Reg. § 1.1031(a)-1 (1967).

55. *E.g.*, *Starker v. United States*, 602 F.2d 1341 (9th Cir. 1979); *Alderson v. Commissioner*, 317 F.2d 790 (9th Cir. 1963); *Starker v. United States*, 35 AFTR 2d 75-1550 (P-H), 75-1 U.S.Tax.Cas. (CCH) ¶ 8443 (D. Or. 1975).

56. *Gregory v. Helvering*, 293 U.S. 465, 469 (1935). *Gregory* first recognized the axiom that substance should supercede form. This principle has become a fundamental rule in the law of taxation.

57. See note 7 *supra* and accompanying text.

58. I.R.C. § 1031(a).

59. I.R.C. §§ 1031-1040 set forth common nontaxable exchanges.

60. Treas. Reg. § 1.1002-1(b); see note 14 *supra*.

61. See note 7 *supra* and accompanying text.

62. I.R.C. § 1031.

63. H.R. REP. NO. 704, 73rd Cong., 2d Sess., (1934) 1939-1 (Pt. 2) C.B. 554, 564. See note 7 *supra* and accompanying text.

cided to defer recognition until the taxpayer closed out his original investment.⁶⁴

Another indicator of congressional purpose is the statutory language itself.⁶⁵ Section 1031(a) states that it is applicable to property "exchanged solely for property of a like kind."⁶⁶ Clearly, nonrecognition treatment applies only to exchanges and not to sales of like-kind property.⁶⁷ To qualify as an exchange, the transaction must be a reciprocal transfer of property⁶⁸ and not a transfer of property solely for monetary consideration.⁶⁹ Identifying whether the transaction is a sale⁷⁰ or an exchange can be determinative in ascertaining the applicability of section 1031.⁷¹ A sale is the receipt of cash for realty,⁷² whereas an exchange is a transfer of property between owners.⁷³ To constitute an exchange the transfer must be a single transaction⁷⁴ and the properties involved must be similar in value and nature.⁷⁵ The property must be "exchanged solely for property of a like kind."⁷⁶ If like-kind realty is the only subject of the exchange then section 1031 will apply to the entire transaction.⁷⁷

One reason for the distinction between a sale and an exchange⁷⁸ is administrative convenience.⁷⁹ By enacting section 1031 it was hoped that the administrative difficulty involved in assessing the value of

64. *Id.*

65. P. BREST, PROCESSES OF CONSTITUTIONAL DECISIONMAKING 19 (1975).

66. I.R.C. § 1031(a).

67. See notes 78-84 *infra* and accompanying text.

68. "The very essence of an exchange is the transfer of property between owners, while the mark of a sale is the receipt of cash for the property." *Carlton v. United States*, 385 F.2d 238, 242 (5th Cir. 1967).

E.g., *Alderson v. Commissioner*, 317 F.2d 790 (9th Cir. 1963); *Coastal Terminal, Inc. v. United States*, 320 F.2d 333 (4th Cir. 1963). See generally 3 MERTENS, FEDERAL INCOME TAXATION § 20.28 (1967).

69. *Id.*

70. See notes 78-84 *infra* and accompanying text.

71. I.R.C. § 1031(a) expressly requires an exchange of like-kind property to qualify for non-recognition treatment. See generally notes 78-84 *infra* and accompanying text.

72. See note 68 *supra* and accompanying text.

73. *Id.*

74. Neither I.R.C. § 1031 nor Treas. Reg. § 1.1031 expressly state that simultaneity is necessary to effect § 1031 treatment. The I.R.S. has agreed, however, that the concept of simultaneity is embodied within the term exchange. See *e.g.*, *Redwing Carriers, Inc. v. Tomlinson*, 399 F.2d 652, 655 (5th Cir. 1968); *Alderson v. Commissioner*, 317 F.2d 790 (9th Cir. 1963).

75. See note 1 *supra* and accompanying text.

76. I.R.C. § 1031(a).

77. *Id.*

78. See notes 67-75 *supra* and accompanying text.

79. *E.g.*, *Starker v. United States*, 602 F.2d 1341, 1356 (9th Cir. 1979); H.R. REP. No. 704, 73rd Cong., 2d Sess., (1934) 1939-1 (Pt. 2) C.B. 554, 564.

property exchanged could be avoided.⁸⁰ No valuation problem exists if a sale occurs, because the parties can then easily ascertain the values of the properties and a resulting gain or loss is readily determinable.⁸¹ In an exchange, however, section 1031 applies because the taxpayer's economic position is the same after the transaction as it was before the transaction.⁸²

The problem with many transfers is that frequently an exchange of parcels of equivalent values is difficult to obtain. Consequently, the possibility of a cash supplement enters the negotiations. While "[a]n exchange is not vitiated because cash is received in addition to property,"⁸³ failure to qualify for section 1031 treatment typically occurs when cash or its equivalent becomes the sole consideration for the transfer.⁸⁴

B. *The Like-Kind Property Requirement*

1. Does the possibility of receiving cash preclude the application of section 1031?

The fundamental purpose of section 1031 is to defer recognition treatment on a continuing investment.⁸⁵ To ensure compliance with this purpose an exchange of like-kind property is required.⁸⁶ It is crucial to identify the purpose of a cash supplement in an exchange to determine whether cash is exchanged as part of the transaction⁸⁷ or whether it is received in lieu of realty.⁸⁸ In the former situation, when cash is received along with the transferred realty to equalize the value of the exchanged lands, the qualifying property will receive nonrecognition treatment.⁸⁹ The cash received will be recognized separately under I.R.C. section 1001(c).⁹⁰ In the latter instance, however, where the receipt of cash in lieu of an exchange of like-kind property occurs,

80. See note 81 *infra* and accompanying text.

81. See generally notes 78-80 *supra* and notes 82-84 *infra* and accompanying text.

82. Juhl Smith, ¶ 75-153 T.C.M. (P-H) (1975).

83. *Alderson v. Commissioner*, 317 F.2d 790, 792 (9th Cir. 1963).

84. *Carlton v. United States*, 385 F.2d 238, 240-43 (5th Cir. 1967).

85. See note 7 *supra*, note 93 *infra* and accompanying text.

86. In order to continue the original investment, the taxpayer must exchange his property for property of a like-kind. I.R.C. § 1031(a). If the character of the property were changed during the course of the transfer the taxpayer would be initiating a new investment, rather than continuing his former investment.

87. See notes 88-91 *infra* and accompanying text.

88. See note 91 *infra* and accompanying text.

89. See note 90 *infra* and accompanying text.

90. See note 6 *supra* and accompanying text.

section 1031 does not apply and gain or loss is recognized.⁹¹

A separate problem arises when taxpayers contemplate the possibility⁹² of receiving cash strictly in lieu of realty, but actually exchange properties, either in a straight property transfer or a property-cash supplement transfer. The application of section 1031 to this situation remains a difficult issue, one predicated on whether the possibility of receiving cash defeats the purpose of the section.⁹³ The Internal Revenue Service had previously demanded recognition of gain or loss where the possibility of receiving cash in lieu of property existed. The agency relied on a strict interpretation of section 1031 and argued that this cash possibility provision excluded nonrecognition treatment.⁹⁴ Consistent application of section 1031 prohibited its use in situations where receipt of cash by the taxpayer was a possibility.⁹⁵ Recently though, courts have rejected this position and have resolved the issue of the section's applicability on the basis of actual results.⁹⁶ If the possibility of a strict cash exchange is proffered by the taxpayers, but like-kind property is ultimately exchanged, courts will examine other elements of the transaction to determine the applicability of section 1031.⁹⁷

2. The Control Factor Examined as a Last Resort

When courts are faced with the difficulty of determining the nature of a transfer,⁹⁸ they sometimes calculate the degree of control the tax-

91. See note 86 *supra* and accompanying text. Receipt of cash for the property clearly changes its character because it terminates the taxpayer's original investment and indicates a sale. Any of these conditions preclude operation of I.R.C. § 1031 and gain or loss is recognized under I.R.C. § 1001(c).

92. *Id.* In these marginal instances some courts (*e.g.*, *Carlton v. United States*, 385 F.2d 238 (5th Cir. 1967); *Alderson v. Commissioner*, 317 F.2d 790 (9th Cir. 1963)) have examined evidence of the taxpayer's intent when determining whether to apply I.R.C. § 1031 to the transaction. While the importance of intent has declined substantially in recent decisions (*e.g.*, *Starker v. United States*, 602 F.2d 1341 (9th Cir. 1979); *Starker v. United States*, 35 AFTR 2d 75-1550 (P-H), 75-1 U.S.Tax.Cas. (CCH) ¶ 8443 (D. Or. 1975)), the taxpayer's contemplation of receiving cash in lieu of realty could arguably preclude I.R.C. § 1031's operation.

93. See notes 7, 70-71, 75-77 *supra* and accompanying text. If the possibility of receiving cash is merely to supplement the exchange, serving to equalize the values of the properties involved, a strong argument favoring I.R.C. § 1031 is likely. Conversely, if the cash possibility indicates tax avoidance or a sale, disguised as an exchange of like-kind property, the purpose of § 1031 is defeated and consequently inapplicable.

94. See note 14 *supra* and accompanying text.

95. See note 92 *supra*.

96. *E.g.*, *Starker v. United States*, 602 F.2d 1341 (9th Cir. 1979); *Alderson v. Commissioner*, 317 F.2d 790 (9th Cir. 1963); *Starker v. United States*, 35 AFTR 2d 75-1550 (P-H), 75-1 U.S.Tax.Cas. (CCH) ¶ 8443 (D. Or. 1975).

97. Because this cash possibility concept is a problem area, courts have examined other factors in determining I.R.C. § 1031's applicability. See notes 17-20 *supra* and accompanying text.

98. See note 19 *supra* and accompanying text.

payer possesses over the property that he will ultimately receive.⁹⁹ If the taxpayer has the right to demand cash in lieu of receiving realty, the exchange may not qualify for section 1031 treatment.¹⁰⁰ Conversely, if the other party has the burden of locating suitable property and will make every attempt to convey suitable realty before transferring cash, courts are more likely to grant nonrecognition treatment to the exchange.¹⁰¹ Within these parameters, case law gives the practitioner minimal guidance in predicting section 1031 treatment.¹⁰²

C. *The Principle of Simultaneity: An Extraneous Requirement?*

The last requirement for invoking section 1031 is simultaneity.¹⁰³ Under a literal interpretation of section 1031, an exchange of property occurs only if each taxpayer owns his respective parcel of land and relinquishes its control at the same time, resulting in a reciprocal, simultaneous exchange of like-kind property.¹⁰⁴ This exchange requirement was relaxed significantly to allow parties without title to desirable realty to acquire it "for the sole purpose of such exchange."¹⁰⁵ If the transfers are framed as an exchange and run through the same escrow, section 1031 treatment generally applies. Exchanges must be effected by the parties but some courts permit exchanges to be conducted through disinterested third parties, agents of the parties, or escrow accounts.¹⁰⁶

99. See notes 100-02 *infra* and accompanying text.

100. Presumably, the courts are reluctant to grant § 1031 treatment to a transaction in which the taxpayer has unlimited control. The control factor refers to which party determines whether the transaction is an exchange or a sale. See *Redwing Carriers, Inc. v. Tomlinson*, 399 F.2d 652, 655 (5th Cir. 1968); *Alderson v. Commissioner*, 317 F.2d 790 (9th Cir. 1963); *124 Front Street, Inc.*, 65 T.C. 6(A) (1975).

101. Frequently, if the other party to the transfer, (not the party claiming nonrecognition treatment under I.R.C. § 1031), has the obligation to locate the property, the party claiming nonrecognition treatment has less control over the result and increased credibility in the court's view. See note 102 *infra* and accompanying text.

102. See note 17 *supra*.

103. Simultaneity refers to the timing of the exchange. Simultaneous is defined as "a word of comparison meaning that two or more occurrences or happenings are identical in time." BLACK'S LAW DICTIONARY 1241 (5th ed. 1979). WEST, 39 WORDS AND PHRASES 431 (perm. ed. 1953) states that "[t]he word 'simultaneous' is a word of comparison meaning that two or more occurrences or happenings are identical in time." *Id.*

104. See *Starker v. United States*, 602 F.2d 1341, 1344-45, 1350, 1355 (9th Cir. 1979). Unlike the timing factor denoted by simultaneity, reciprocity refers to the obligatory factor, connoting mutuality. BLACK'S LAW DICTIONARY 1141 (5th ed. 1979) defines reciprocal as "given or owed mutually as between two persons; interchanged. Reciprocal obligations are those due from one person to another and vice versa."

105. *Alderson v. Commissioner*, 317 F.2d 790, 793 (9th Cir. 1963).

106. While running both transfers through the same escrow account is not necessarily indica-

Section 1031 was enacted to facilitate the Internal Revenue Service's task of assessing the recognition of gain or loss. The section postpones assessment until a sale occurs, thereby allowing the sale price to fix the value of the properties involved.¹⁰⁷ If a simultaneous exchange occurs, the Internal Revenue Service can better scrutinize the transaction and insure taxation of gain at a future time when the property is sold.¹⁰⁸ The Internal Revenue Service has insisted that the term exchange embody the concept of a simultaneous occurrence.¹⁰⁹ In recent years taxpayers have argued that a reciprocal exchange is sufficient for qualification under section 1031.¹¹⁰ Simultaneous transfers are difficult to accomplish and courts have recently recognized that where reciprocal exchanges¹¹¹ are in accordance with the congressional purpose of section 1031,¹¹² nonrecognition treatment should not be denied merely because simultaneity is lacking.¹¹³

The recent trend has been to broadly construe section 1031.¹¹⁴ After all relevant factors are considered,¹¹⁵ the most important one appears to be whether the substance of the transaction falls within the congressional purpose of section 1031.¹¹⁶ Courts seem willing to extend nonrecognition treatment to reciprocal exchanges of property¹¹⁷ where the taxpayer is continuing, rather than closing out, his original investment.¹¹⁸

tive of literal simultaneity, the court allowed the use of the same escrow by all parties involved to impute simultaneity in law. See note 188 *infra* and accompanying text.

Exchanges must be effected by the parties, but some courts permit these exchanges to be conducted through disinterested third parties. In Rev. Rul. 75-291, 1975-2 C.B. 332 exchange treatment was afforded to a three-party transaction including improvements.

Attorneys frequently act as their clients' agents in these types of transactions. *E.g.*, *Coupe v. Commissioner*, 52 T.C. 394 (1969). See generally *Rogers*, 44 T.C. 126; *Juhl Smith*, ¶ 75-153 T.C.M. (P-H) (1975).

107. See note 81 *supra* and accompanying text.

108. *Id.*

109. See note 103 *supra* and accompanying text. See also *Alderson v. Commissioner*, 317 F.2d 790 (9th Cir. 1963).

110. 317 F.2d 790 (9th Cir. 1963).

111. *Id.*

112. See note 7 *supra* and accompanying text.

113. *Starker v. United States*, 602 F.2d 1341 (9th Cir. 1979).

114. *Id.* at 1342.

115. See notes 18-20 *supra* and accompanying text.

116. See notes 18, 53-54 *supra* and accompanying text.

117. *Starker v. United States*, 602 F.2d 1341 (9th Cir. 1979).

118. *Id.* See note 7 *supra* and accompanying text.

D. *Legal Foundations: A Case in Point*

*Alderson v. Commissioner*¹¹⁹ provides an excellent predicate from which to analyze the *Starker* courts' subsequent reasoning and decisions.¹²⁰ Upon examining the facts and issues in *Alderson* the modification of section 1031 by the *Starker* cases becomes readily apparent.

In *Alderson*,¹²¹ the taxpayer transferred property to the Alloy Die Casting Company¹²² by drafting an escrow agreement constituting a purchase and sale in which the taxpayer agreed to sell his property to Alloy for \$172,871.40.¹²³ At a later date the taxpayer, Alderson, selected realty¹²⁴ which he desired to obtain in exchange for the property¹²⁵ he had already transferred to Alloy.¹²⁶ He ultimately received this property in payment of Alloy's \$192,891.40 liability.¹²⁷ The issue was whether the transaction constituted a sale, the gain from which was recognizable under section 1002,¹²⁸ or whether it constituted a nontaxable exchange within the meaning of Section 1031¹²⁹ of the Internal Revenue Code.¹³⁰

The government contended that the original agreement between Alderson and Alloy was a sale of land rather than an exchange.¹³¹ The taxpayers contended, however, that the amendment of the escrow agreement to effectuate a transfer of like-kind realty between the taxpayer and Alloy was in fact an exchange and should be afforded nonrecognition treatment.¹³²

The court adopted the taxpayer's reasoning and afforded nonrecognition treatment.¹³³ While the exchange was not within the exact let-

119. 317 F.2d 790 (9th Cir. 1963).

120. See notes 22 & 23 *supra* and accompanying text.

121. See note 119 *supra*.

122. Alloy was the corporate transferee in *Alderson* and was in a position analogous to Crown and Longview Fibre in the *Starker* cases.

123. *Alderson v. Commissioner*, 317 F.2d 790, 791 (9th Cir. 1963).

124. *Id.* The realty selected by Alderson was the Salinas property located in Monterey County, California.

125. See note 123 *supra* and accompanying text.

126. Alderson transferred the Buena Park property to Alloy on May 21, 1957.

127. See note 123 *supra* and accompanying text. Alderson and Alloy agreed upon the value of the Buena Park realty and set Alloy's liability after receiving this property at \$192,891.40.

128. I.R.C. § 1002. This section authorized recognition of gains or losses resulting from sales or exchanges. I.R.C. § 1001(c) currently addresses recognition of gain replacing I.R.C. § 1002.

129. I.R.C. § 1031 affords nonrecognition treatment.

130. 317 F.2d 790 (9th Cir. 1963).

131. *Id.* at 792-93.

132. *Id.* at 793-94.

133. *Id.* at 795.

ter of section 1031,¹³⁴ the court found no hint of fraud or camouflage in the transaction and looked beyond the form to the substance of the transfer. In doing so, it relied on *Mercantile Trust Co. v. Commissioner*¹³⁵ and held that "[t]he property was, in fact, exchanged. That fact is controlling here."¹³⁶ Focusing on the actual result, the exchange, *Alderson* established the principle that in section 1031 cases, absent any hint of fraud, the court looks to actual occurrences, not recitations of intent.¹³⁷

Prior to *Alderson* the model section 1031 transaction would have included the parties' draft of an exchange agreement at the deal's inception,¹³⁸ ascertaining the value of the properties involved,¹³⁹ in order to determine the fairness of the transfer and the true nature of the transaction.¹⁴⁰ But *Alderson* extended nonrecognition treatment to the Alloy transaction despite the taxpayer's statement of intent.¹⁴¹ The court allowed the amended escrow agreement to satisfy the intent factor, since the Aldersons' ultimate intent and performance complied with the exchange requirement under section 1031.¹⁴²

IV. THE TAXPAYERS' TRIUMPH: THE *STARKER* CASES

The *Starker* opinions are important from a practical standpoint because they give the taxpayer greater latitude in effecting nonrecognized property transfers and delayed tax consequences.¹⁴³ By elevating to a determinative status the question whether the substance of the transfer complies with section 1031's congressional purpose, the *Starker* courts have given the practitioner a new method to defer tax benefits when planning corporate reorganization and transfers.¹⁴⁴ The *Starker I* opinion¹⁴⁵ disposes of the government's argument¹⁴⁶ by em-

134. See note 1 *supra* and accompanying text.

135. 32 B.T.A. 82 (1935).

136. *Alderson v. Commissioner*, 317 F.2d 790, 795 (9th Cir. 1963).

137. 317 F.2d 790 (9th Cir. 1963).

138. *Id.* *Alderson* allowed an amended agreement to qualify for nonrecognition treatment.

139. 317 F.2d 790 (9th Cir. 1963). This valuation process facilitates the use of an escrow account and determines the necessity of a cash supplement in implementing the exchange.

140. See note 7 *supra* and accompanying text.

141. See 317 F.2d 790, 791 (9th Cir. 1963). The factual pattern demonstrates the taxpayer's intent throughout the course of the negotiations as well as the transaction.

142. *Alderson v. Commissioner*, 317 F.2d 790, 791, 795 (9th Cir. 1963).

143. See note 27 *supra* and accompanying text. Because of the similarity between *Starker I* and *Starker II* plural references to both are frequently employed throughout this article.

144. See note 7 *supra*.

145. 35 AFTR 2d 75-1550 (P-H), 75-1 U.S.Tax.Cas. (CCH) ¶ 8443 (D. Or. 1975).

146. *Id.*

phasizing the statutory purpose of deferring recognition of intermittent gain on a continuation of an existing investment.¹⁴⁷ Although *Starker I*'s position seems evident, *Starker II* expressly addresses each factor and reconciles the conflicting arguments.¹⁴⁸ The *Starker* courts specifically addressed three issues involved in interpreting section 1031¹⁴⁹ and resolved all of them in the taxpayer's favor.¹⁵⁰

The principal impact of the *Starker* cases is their advancement of the policy and congressional purpose requirements as conditions precedent to nonrecognition treatment.¹⁵¹ The effect of this modification is to make it easier for the taxpayer to invoke section 1031 nonrecognition treatment.¹⁵² The *Starker* opinions also modify traditional constructions of the like-kind property requirement¹⁵³ and allow receipt of something less than realty to comply with section 1031 requisites.¹⁵⁴ In perhaps the most liberal application of the like-kind property requirement to date, the *Starker* cases held that section 1031 was satisfied where a promise to convey parcels in the future was exchanged for a present realty conveyance. This exchange was held to satisfy the like-kind requirement of I.R.C. section 1031.¹⁵⁵ In addition, both opinions held that the unrealized possibility of a cash sale did not vitiate nonrecognition treatment.¹⁵⁶ Finally, the *Starker* courts¹⁵⁷ extended their interpretation of the simultaneity concept to encompass reciprocal transfers¹⁵⁸ for purposes of section 1031 treatment.¹⁵⁹ Without discarding the simultaneity principle, the acceptance by *Starker I and II* of mere reciprocity presents the greatest departure to date from the princi-

147. See note 7 *supra* and accompanying text.

148. The *Starker II* opinion expressly relies upon the *Starker I* holding and fully addresses the rationale thereof. See 602 F.2d 1341 (9th Cir. 1979). As demonstrated by the brevity of the *Starker I* opinion, the court offers little explanation of the rationale underlying its holding. Upon close scrutiny, however, the rationale behind its bold ruling is evident.

149. See notes 18-20 *supra*, notes 161-92 *infra* and accompanying text.

150. *Id.*

151. See note 147 *supra* and accompanying text.

152. *Id.*

153. 602 F.2d 1341, 1347, 1355 (9th Cir. 1979); 35 AFTR 2d 75-1550 (P-H), 75-1 U.S.Tax.Cas. (CCH) ¶ 8443 (D. Or. 1975).

154. 602 F.2d 1341, 1355 (9th Cir. 1979); 35 AFTR 2d 75-1550 (P-H), 75-1 U.S.Tax.Cas. (CCH) ¶ 8443 (D. Or. 1975).

155. See note 154 *supra*.

156. *Starker v. United States*, 602 F.2d 1341, 1354 (9th Cir. 1979); *Starker v. United States*, 35 AFTR 2d 75-1550 (P-H), 75-1 U.S.Tax.Cas. (CCH) ¶ 8443 (D. Or. 1975).

157. See note 27 *supra*.

158. 602 F.2d 1341, 1347 (9th Cir. 1979); 35 AFTR 2d 75-1550 (P-H), 75-1 U.S.Tax.Cas. (CCH) ¶ 8443 (D. Or. 1975).

^f 159. *Starker v. United States*, 602 F.2d 1341, 1353 (9th Cir. 1979).

ple of simultaneity.¹⁶⁰

A. *Substance Meeting Congressional Purpose: A New Condition Precedent*

The paramount feature of the *Starker* cases is their adoption of the policy and congressional purpose approach. By elevating this requirement to a condition precedent to nonrecognition treatment the *Starker* cases have established a new keystone for section 1031 analysis.

The alternative method of testing section 1031's applicability is to examine the taxpayer's intent at the commencement of the transaction to see if the transaction falls within the letter of section 1031.¹⁶¹ While intent was important in those earlier cases which involved the possible receipt of cash¹⁶² and which utilized a mechanical test, its significance has recently waned.¹⁶³ In *Starker II* the court summarized recent decisions by emphasizing the actual transaction over the parties initial declarations of intent.¹⁶⁴ Intent has not been discarded entirely, but its importance has been substantially diminished as compared to the actual transaction.¹⁶⁵ Upon these bases the *Starker* courts clearly rejected the government's contention which had precluded section 1031 treatment for transfers involving the possibility of a cash exchange in lieu of receiving realty.¹⁶⁶

B. *The Like-Kind Property Requirement*

Section 1031 requires that the character of property exchanged be property of a like-kind.¹⁶⁷ Disregarding form and stressing substance,¹⁶⁸ the *Starker* cases broke new ground by according section 1031 treatment to an exchange of realty for personalty. *Starker I* allowed a mere promise to convey like-kind property in the future to

160. See note 158 *supra*.

161. Generally this is done by examining the written agreement between the parties at the transaction's inception. *E.g.*, *Starker v. United States*, 602 F.2d 1341, 1342-43 (9th Cir. 1979); *Alderson v. Commissioner*, 317 F.2d 790, 791 (9th Cir. 1963); *Starker v. United States*, 35 AFTR 2d 75-1550 (P-H), 75-1 U.S. Tax. Cas. (CCH) ¶ 8443 (D. Or. 1975).

162. See *Carlton v. United States*, 385 F.2d 238 (5th Cir. 1967).

163. See *Starker v. United States*, 602 F.2d 1341, 1353-54 (9th Cir. 1979); *Alderson v. Commissioner*, 317 F.2d 790, 793-94 (9th Cir. 1963).

164. *Starker v. United States*, 602 F.2d 1341, 1355 (9th Cir. 1979).

165. *Id.* at 1353-54.

166. *Id.*

167. I.R.C. § 1031(a).

168. *Gregory v. Helvering*, 293 U.S. 465 (1935).

qualify for nonrecognition treatment.¹⁶⁹ *Starker II* found that a third party purchaser's right to acquire specific realty satisfied the like-kind property requirement.¹⁷⁰ The Internal Revenue Service applied the technical formula for like-kind property and declared that section 1031 was inapplicable.¹⁷¹ The taxpayers responded by urging a rejection of the government's realty-personalty distinction.¹⁷² They argued that the court should look past the form to the substance of the transaction, which would ultimately result in an exchange of real property.¹⁷³ The *Starker* courts accepted the taxpayers' rationale.¹⁷⁴

1. The Possibility of a Cash Exchange

Under the like-kind property requirement of section 1031, a problem is presented because of the possibility of receiving cash in lieu of realty.¹⁷⁵ Although actual receipt of cash in exchange for realty precludes 1031 treatment, where the possibility is envisaged as an exchange alternative, the issue of whether the like-kind property requirement is satisfied has not been conclusively resolved.¹⁷⁶

The *Starker* courts confronted this issue because of the possibility that the taxpayers might receive cash instead of property.¹⁷⁷ In both of the *Starker* cases the taxpayers preferred the receipt of realty to cash.¹⁷⁸ They anticipated difficulty in locating suitable realty and included a cash exchange clause in their agreements.¹⁷⁹ The exchange agreement provided that the Starkers would have no right to demand cash instead of property in exchange for the realty they transferred to the companies.¹⁸⁰ In addition, the taxpayers had no control over the companies' respective purchases of land, with the express exception that the land purchased would have to be suitable to the Starkers.¹⁸¹ Since the issue

169. See note 22 *supra* and accompanying text.

170. *Starker v. United States*, 602 F.2d 1341, 1355 (9th Cir. 1979).

171. *Id.*

172. *Id.*

173. *Id.*

174. *Id.* See note 56 *supra* and accompanying text.

175. See notes 85-97 *supra* and accompanying text.

176. See notes 92-95 *supra* and accompanying text.

177. *Starker v. United States*, 602 F.2d 1341, 1343 (9th Cir. 1979); *Starker v. United States*, 35 AFTR 2d 75-1550 (P-H), 75-1 U.S.Tax.Cas. (CCH) ¶ 8443 (D. Or. 1975).

178. *Id.*

179. *Starker v. United States*, 602 F.2d 1341, 1342-43 (9th Cir. 1979); *Starker v. United States*, 35 AFTR 2d 75-1550 (P-H) 75-1 U.S.Tax.Cas. (CCH) ¶ 8443 (D. Or. 1975).

180. See note 177 *supra*.

181. *Starker v. United States*, 35 AFTR 2d 75-1550 (P-H) 75-1 U.S.Tax.Cas. (CCH) ¶ 8443 (D. Or. 1975).

of acceptability was not addressed in the opinion it was probably perceived as an insignificant issue.¹⁸² The Internal Revenue Service argued that the taxpayers' investment would terminate upon receipt of cash and therefore this possibility should preclude nonrecognition treatment.¹⁸³ The taxpayers countered by claiming that since taxable treatment is applied retrospectively, the determination should be made in light of the actual result.¹⁸⁴ The *Starker* courts, relying on *Alderson*,¹⁸⁵ agreed with the taxpayers and held that the final result controlled.¹⁸⁶ If the mere possibility of receiving cash instead of property never materialized and the property exchange resulted in a continuation of the taxpayers' original investment, section 1031 treatment was not precluded.¹⁸⁷

C. *Has the Simultaneity Requirement Become Unreasonable?*

Under a literal interpretation of section 1031 a simultaneous exchange of like-kind property will precipitate nonrecognition treatment. In *Alderson* the simultaneity requirement was relaxed to include exchanges resulting from the use of the same escrow account, thereby implying simultaneity in law.¹⁸⁸ Although *Starker I* did not expressly reject the principle of simultaneity it did imply that simultaneity was an artificial condition that could be overlooked if the transaction was indeed a reciprocal exchange.¹⁸⁹ *Starker II* endorsed *Starker I* and held that the two year time lapse was inconsequential¹⁹⁰ for purposes of nonrecognition treatment.¹⁹¹ In the wake of the *Starker* decisions it is evident that mere reciprocity will suffice for the traditional simultaneity requirement under section 1031.¹⁹²

182. *Id.*

183. *Starker v. United States*, 602 F.2d 1341, 1353-54 (9th Cir. 1979); *Starker v. United States*, 35 AFTR 2d 75-1550 (P-H), 75-1 U.S.Tax.Cas. (CCH) ¶ 8443 (D. Or. 1975).

184. *Id.*

185. See note 119 *supra*.

186. *Starker v. United States*, 602 F.2d 1341, 1355 (9th Cir. 1979); *Starker v. United States*, 35 AFTR 2d 75-1550 (P-H), 75-1 U.S.Tax.Cas. (CCH) ¶ 8443 (D. Or. 1975).

187. See note 1 *supra* and accompanying text.

188. 317 F.2d 790, 791 (9th Cir. 1963).

189. *Id.*

190. *Starker v. United States*, 602 F.2d 1341, 1348 (9th Cir. 1979).

191. *Id.*

192. *Id.* at 1344-45.

V. IMPLICATIONS OF THE TAXPAYERS' VICTORY IN THE *STARKER* CASES

The *Starker* courts¹⁹³ were confronted with the opportunity to clarify the limits of nonrecognition treatment under section 1031. Their choice was to either extend or confine the parameters established in *Alderson*.¹⁹⁴ Relying on *Alderson*, the courts relaxed the traditional limits of section 1031,¹⁹⁵ and expanded the range of like-kind exchanges which qualified for section 1031 treatment. This interpretation of section 1031 presents a new degree of flexibility to the taxpayer who seeks to avoid immediate tax consequences with regard to exchanged properties. As long as the ultimate transaction falls within the congressional purpose and there is no hint of taxpayer fraud, nonrecognition treatment will be accorded.¹⁹⁶

The courts' interpretation was predicated on an approach which favored policy considerations¹⁹⁷ over a mechanical application of section 1031 provisions.¹⁹⁸ In an incisive analysis of the traditional section 1031 factors,¹⁹⁹ the *Starker* courts demonstrated their deference to congressional purpose by elevating this policy and the congressional purpose test to a condition precedent to invoking nonrecognition treatment.²⁰⁰ *Starker II* wisely encouraged courts to adopt this condition precedent, which served as the keystone of analysis under *Starker II*. This struck an exceptional balance by requiring the taxpayer to meet the condition precedent without discarding consideration of the other traditional section 1031 factors.²⁰¹ Adopting a flexible approach

193. *Starker v. United States*, 602 F.2d 1341 (9th Cir. 1979); *Starker v. United States*, 35 AFTR 2d 75-1550 (P-H), 75-1 U.S.Tax.Cas. (CCH) ¶ 8443 (D. Or. 1975).

194. *Alderson v. Commissioner*, 317 F.2d 790 (9th Cir. 1963).

195. See notes 53-118 *supra* and accompanying text.

196. *Starker v. United States*, 602 F.2d 1341, 1355 (9th Cir. 1979); *Starker v. United States*, 35 AFTR 2d 75-1550 (P-H), 75-1 U.S.Tax.Cas. (CCH) ¶ 8443 (D. Or. 1975). An examination of the following cases decided by other circuit courts of appeal and the U.S. Tax Court, interpreting I.R.C. § 1031, follows: *Leslie Co. v. Commissioner*, 539 F.2d 943 (3d Cir. 1976); *Molbreak v. Commissioner*, 509 F.2d 616 (7th Cir. 1975); *Redwing Carriers, Inc. v. Tomlinson*, 399 F.2d 652 (5th Cir. 1968); *Coastal Terminals, Inc. v. United States*, 320 F.2d 333 (4th Cir. 1963); *Jordan Marsh Co. v. Commissioner*, 269 F.2d 453 (2d Cir. 1959); *Century Electric Co. v. Commissioner*, 192 F.2d 155 (8th Cir. 1951); *Trenton Cotton Oil Co. v. Commissioner*, 147 F.2d 33 (6th Cir. 1945); *Portland Oil Co. v. Commissioner*, 109 F.2d 479 (1st Cir. 1940); *Biggs v. Commissioner*, 69 T.C. 905 (1978).

197. These policy considerations determine whether the substance of the transfer meets § 1031's congressional purpose.

198. See notes 14, 138-42 *supra* and accompanying text.

199. See note 1 *supra* and accompanying text.

200. *Starker v. United States*, 602 F.2d 1341 (9th Cir. 1979); *Starker v. United States*, 35 AFTR 2d 75-1550 (P-H), 75-1 U.S.Tax.Cas. (CCH) ¶ 8443 (D. Or. 1975).

201. *Id.*

eliminated the necessity of needlessly balancing the traditional factors in cases warranting nonrecognition treatment as evidenced by section 1031's congressional purpose. The *Starker* courts took great liberty in construing the facts to satisfy the strict requirements of the nonrecognition statute while avoiding its artificial obstacles.²⁰²

The major problem with elevating the congressional purpose test to a determinative status is the potential for imprecise and inconsistent results in application. Examining the holdings from a practical perspective, many problems of proof remain. Although proof of the traditional factors remain unchanged following *Starker*, the necessity of satisfying the burden of proof as to the condition precedent remains difficult. Because of its recently elevated status, a taxpayer must prove this factor before he is allowed to proceed in employing proof of the other factors in substantiating his position in section 1031 cases. The liberal construction which *Starker* accorded to traditional section 1031 factors²⁰³ intimates that the problem is one of degree rather than kind. Specifically, the question is not whether a given transaction is one of like-kind, or simultaneously effected, but how far these requirements may reasonably be elasticized to encompass the given facts in a particular case.

Starker II appears to have shifted the emphasis from examining whether the facts of the case fit the test, to whether the test can be tailored to fit the facts. Inherent in any broad test is the problem of defining a limitation on this latitude. This is the unresolved issue that emerges from *Starker II*. In the final analysis, however, *Starkers'* sole adherence to policy considerations is exceedingly preferable to the mechanical approach advanced by the government. Although the I.R.S. may disagree, it is certainly preferable to risk over-inclusion under section 1031 rather than retain the presently existing under-inclusion. Recognizing the intended benefits of a section 1031 exchange, the *Starker* decisions also serve to induce business expansion by encouraging a taxpayer to maximize his deferment opportunities if his business exchange meets the condition precedent, without delaying nonrecognition treatment merely because his exchange does not precisely fit the language of I.R.C. section 1031. Although precision and predictability are incidents of a mechanical approach, the court

202. See note 1 *supra* and accompanying text. The intent, like-kind property, cash possibility, control, and simultaneity factors are obstacles that preclude taxpayers, whose exchanges constitute continuations of their initial investments, from receiving § 1031 treatment.

203. 602 F.2d 1341, 1352-53 (9th Cir. 1979).

accurately perceives its role as an interpreter, not a prognosticator, of I.R.C. section 1031. Thus, *Starker* prudently adopts the policy approach pronounced in 1031's congressional history and espoused by the taxpayer.²⁰⁴

Closer scrutiny of *Starker II* suggests other underlying reasons for its holding. Implying its dissatisfaction, the court adamantly insisted that the government adhere to its previously asserted positions in section 1031 cases. In an apparently hostile response to the I.R.S., *Starker II* searches the progeny of section 1031 case law, to bind the government to its past positions in similar cases, without allowing it the opportunity to reappraise or modify its arguments. The court's reprisal is most evident in its disposition of the collateral estoppel and simultaneity issues.

Attempting to refute the operation of collateral estoppel in *Starker II*,²⁰⁵ the government feebly attempts to distinguish the facts and legal issues from those involved in *Starker I*. The *Starker II* court draws attention to the fact that, although the government disagreed with the *Starker I* decision, it voluntarily dismissed its appeal.²⁰⁶ Consequently, the government was collaterally estopped in *Starker II* from relitigating similar issues decided in *Starker I*.²⁰⁷ The court shrewdly noted the difference between the government's vigorous stance in *Starker II*, as opposed to its mere disapproving acquiescence to the unfavorable *Starker I* ruling. Appearing to berate the government, the *Starker II* opinion implied that *Starker I*'s precedential value was not diminished when applied to the *Starker II* ruling, merely because the refund in this case was ten times the amount of money that was at stake in *Starker I*.²⁰⁸

In another retaliatory ruling, the *Starker II* court invoked nonrecognition treatment despite the lack of simultaneity.²⁰⁹ Predicating its ruling upon the government's position in a 1968 Fifth Circuit case, *Redwing Carriers, Incorporated v. Tomlinson*,²¹⁰ the court held that I.R.C. section 1031 should operate despite the absence of precise simultaneity. According nonrecognition treatment to the taxpayer's loss in *Redwing*, the government persuaded the court that reciprocal exchanges occur-

204. *Id.*

205. *Id.* at 1344-50.

206. *Id.* at 1343.

207. *Id.* at 1350.

208. *Id.* at 1343.

209. *Id.* at 1354-55.

210. 399 F.2d 652 (5th Cir. 1968).

ring "at or about the same time"²¹¹ sufficiently qualified for nonrecognition treatment. In an attempt to distinguish *Starker II* from *Redwing*, the government argued that the *Starker* transfers were separated by a two year time period.²¹² Consequently, such a blatant disregard for the simultaneity requirement should preclude section 1031 treatment. In rejecting this legitimate distinction, *Starker II* held that the *Redwing* holding authorized nonrecognition treatment despite the lack of simultaneity in *Starker*.

VI. CONCLUSION

The *Starker* cases signal an era of new liberality in the application of section 1031 nonrecognition treatment to those exchanges which fall within its parameters. The courts repudiated the Internal Revenue Service's narrow, mechanical interpretation of section 1031 in favor of a broader, policy and congressional purpose test which serves as a threshold requirement. The component parts of the former test have also been expanded. The notion of like-kind property may encompass personalty instead of realty, and the mere potential of a cash exchange does not preclude section 1031 treatment where the property is actually exchanged. The requirement of simultaneity is perceived as not requiring an exact time exchange but rather a reciprocal exchange.

The *Starker* decisions represent a reprisal to the government's persistently rigid and mechanical application of section 1031. But these decisions represent something more. They represent a signal to other circuit courts to interpret the requirements of section 1031 in accordance with the purposes for which it was enacted, in light of common sense and practical application. The result will be an invigorated market for business related property exchanges and fairness to the taxpayer as well as the I.R.S.; ultimately, gain will be recognized and the government will get its due.

Ann L. Muchin

211. *Id.* at 655.

212. 602 F.2d 1341, 1355 (9th Cir. 1979).